TESTIMONY OF ROY NEEL
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BEFORE
THE COMMITTEE ON COMMERCE, SCIENCE AND TRANSPORTATION
UNITED STATES SENATE

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Thank you very much, Mr. Chairman, for giving me the opportunity to testify at this hearing. The hearing is timely and an important one. As the President and CEO of the United States Telecom Association, I am here on behalf of the over 1100 local telephone companies that we represent throughout the United States. Our members are at the front lines of local competition and the thrust of my testimony today will be that if you are a business in a large urban market you have many competitive opportunities. In contrast, if you are a residential customer in a rural market you will have very limited competitive options. We also expect that cable operators who are today providing telephone service in some markets will greatly expand that service to other markets.

Let me begin by quoting a recent remark made by the Chairman of the Federal Communications Commission, William E. Kennard with respect to local competition. Chairman Kennard made the following statement at a hearing before the House Commerce Committee=s Subcommittee on Telecommunications, Trade and Consumer Protection on October 26, 1999.

> In the local phone sector, we are starting to see the fruits of our pro-competitive policies. There are now at least 20 publicly traded CLEC with a total market cap of 33 billion (dollars). That compares with only 6 CLECs with a market cap of $1.3 billion at the time of the passage of the 1996 Act. ***In the first quarter of 1999 alone, almost a million CLEC access lines were installed***. (Emphasis

The Local Market Is Open

As a starting point, let me share with you some summary information on the state of local competition that USTA provided to the House Commerce last December (1998):

Demonstrate Competitive Activity with*: *LEC Total

PSC CLEC Certifications	9,762
Signed Agreements with Competitors	5,475
PSC Approved Agreements	2,881
Unbundled Loops	285,402
Resold Lines	2,849,469
Resold Business Lines	1,650,092
Resold Residential Lines	1,260,751
Resold Coin	35,226
Resold Private Lines/Data CKTs	78,756
Minutes of Use (MOUs) Exchanged (Since 1995)	307.1 Billion
Interconnection Trunks in Operation (Local Only)	1,801,977
Collocation Arrangement (activity)	
Physical	2,385
Virtual	2,220
Wire Centers with Collocation	4,956
Number of Lines in Offices with One or More Collocators	44,593,956
NXX Codes Assigned to CLECs	11,413
Total CLEC-Provided Local Exchange Service Lines	3,510,476

The above information was compiled by our local telephone companies and its shows that there are a lot of competitive entrants. This original research done by USTA has been validated by subsequent studies done by both us and others. I also intend to demonstrate to you that, as Chairman Kennard noted, the competitive situation has become much more competitive in just this last year of ***1999***.

In May of this year, USTA submitted to the FCC (CC Docket No. 96-98) a report prepared by Peter Huber and Evan Leo for the Bell operating companies and GTE entitled the ***UNE FACT REPORT***. The report was done in contemplation of the UNE remand proceeding at the FCC so it emphasized network elements, such as switches which are a key component to facilities-based local competition. This extensive research confirmed our earlier (December 1998) assessment regarding the

state of local competition. This report showed, for instance, that 167 CLECs had deployed 724 switches in 320 cities as of March 1999. A chart showing the locations of the switches is attached to my testimony, and it graphically corroborates my earlier statement about where the competition is going. What leaps off the page of the attached chart is that competitors have business plans that target urban areas. In Washington, D.C. , for instance, 14 CLECs operate 23 switches in the Washington Metropolitan Statistical Area.

The ***UNE FACT REPORT*** secondly looked at 3 categories of RBOC/GTE Wire Centers those with 40,000 lines or more, those with 30,000 lines or more and those with 20,000 lines or more (see attached charts). The research showed dispositively that wire centers with the greatest density have the greatest degree of competition, thus providing probative evidence that the CLEC business plans place their emphasis on business customers, as it is within the reach of these dense wire centers that the great preponderance of business locate. Drive around Washington today, for instance, and observe where the streets are being torn up to install fiber optic cable and this point will be made. As our ***UNE FACT REPORT*** further observes, there is more ***local*** competition three and a half years after passage of the 1996 Act than there was three and a half years after ***EXCUNET II*** opened up the ***long distance*** market to competition in 1978, by requiring AT&T to interconnect with long distance competitors.

In the advanced service market, the ***UNE FACT REPORT*** points out that the competitive situation is even more pronounced. ***CLECs already lead incumbent local exchange carriers (ILECs) in providing advanced services over ILEC loops.*** CLECs offer advanced services to over 5 million homes and ALTS, the CLEC trade association, predicts that number will quadruple in 1999, with data constituting 20 percent of CLEC revenue by 1999.

Our two studies on local competition have been confirmed by the ***Local Competition: August 1999*** report of the FCC=s Common Carrier Bureau. This report indicates that by the end of June 1999, facilities-based CLECs were in every state and in all but 18 of the nations 193 LATAs. Furthermore, this report=s assessment of where competition is developing corresponds precisely with our own analysis. The report says:

> One such assertion, made by virtually all analysts is that ***competition*** is ***emerging most rapidly in urban business districts***. ***This observation meets***

> ***with prior expectations, which are based on historical telephone cost and usage patterns***. For example, a large body of literature describing the cost structure of the telephone network supports the conclusion that local ***telephone companies incur greater costs by serving rural customers than by serving urban customers. Furthermore, business customers, which are often concentrated in urban areas, have historically*** used the network more intensively than residential customers. Consequently, ***local telephone companies have historically collected a disproportionate share of their local telephone revenue from business customers***. In concert, these factors indicate that the high-volume, low-cost customers in urban business districts are more attractive to new entrants than either rural or residential customers. (Emphasis Added)

The business plans of CLECs reflect the economic realities of the marketplace. There is considerable profit to be made in serving business customers, but there is less in serving the overwhelming majority of residential customers. US West in its territory has, for instance, lost to competitors 70% of its high capacity traffic. For most residential customers in most states, local residential telephone service is still highly subsidized by a 50 year old system of implicit subsidies. Investors behind CLECs know this and well over 95% of all capital flowing to CLECs is targeted at business customers, even though these customers represent only 35% of the total U.S. telecommunications market. CLECs are also no longer small companies as their market capitalization in 1999 is larger than the United States airline industry.

The competition situation is changing and growing everyday. Just yesterday, for instance, Bell South announced that Network One will spend $500 million with Bell South=s unbundled network element combinations or so-called UNE-P. This is the largest such deal reached to date in the telecommunications industry.

CRITICAL IMPEDIMENTS TO THE FURTHER DEVELOPMENT OF LOCAL TELEPHONE COMPETITION

1. Lack of Comprehensive Universal Service Reform.

In March 1994, USTA submitted to this Committee its universal service amendments to Senator Hollings= bill, S. 1822. We had been, by this time in 1994, internally assessing and developing for 3 years our policy recommendations to preserve universal service in an era of local competition. USTA=s evaluation concluded that the system of implicit subsidies could not survive in a

competitive era; that subsidies need to be explicit; that all providers of telecommunications services needed to contribute to universal service preservation; and that local telephone rates had to be rebalanced. The USTA amendments proposed four basic universal service proposals for a competitive era:

1C eliminate ***implicit*** universal service subsidies

2C require ***all providers*** of telecommunications service to contribute to the preservation of universal service

3C establish ***explicit*** subsidies to provide adequate and sustainable support for universal service

4C authorize ILECs to ***rebalance*** their local telephone rates

During deliberations on the 1996 Act, several highly motivated Senators formed a coalition that became known as the ***AFarm Team@*** to protect telephone services, especially in rural areas. Senators, including Dorgan, Exon, Pressler, Rockefeller, Kerrey (Nebraska) and Stevens made this objective the centerpiece in the debate on legislation that ultimately became the 1996 Act. By August 1994, the ***AFarm Team@*** had embraced three of these four USTA principles. Elimination of implicit subsidies *was not adopted by the* ***AFarm Team,@*** *but rate rebalancing was. (See, Rural* Area Amendments ***AFarm Team@*** Draft III C August 1, 1994.)

I am emphasizing the Senate and the ***AFarm Team@*** deliberations, because it was the Senate=s universal service provisions that were adopted by the 1996 Act. The 1996 Act embraced three of the four USTA universal service principles or at least that is what we thought on February 8, 1996 when President Clinton signed the Telecommunications Act of 1996. The 1996 Act did quite clearly rejected our rate rebalancing proposal. Had it been adopted local competition in my judgment would be much further along, especially with respect to local residential competition. Most states are reluctant to rebalance rates, because rebalancing rates results in local residential telephone rate increases and local business telephone rate decreases. Some states, such as Nebraska have rebalanced rates and created a state universal telephone service fund, and it has proven successful. ***In our March 1994 submission to you, we emphasized how important rate rebalancing is and we said: AThe universal service provisions of this legislation do not permit the adjustment of prices for telecommunications services, especially in light of the competition that it fosters.@*** In other words, if you want local residential telephone competition to flourish you must rebalance local

telephone rates.@

The FCC was required by Section 254 of the 1996 Act to complete action on universal service reform by May 8, 1997. To date, the FCC has failed to do so. This failure in combination with the Congress= rejection of rate rebalancing in the 1996 the Act has perpetuated the economic distortions that existed at the time of the 1996 Act=s passage and that work against the competitive goals of the Act. I am talking here about the fact that local residential service is supported by a vast array of implicit subsidies mechanisms which include: interstate access charges, vertical services (*e.g.*, call waiting and caller ID), local business service, intrastate toll services and urban to rural support. These subsidy practices which began in 1949 and which continue unabated today result in ILEC provision of residential service in many areas at below cost rates.

Without rate rebalancing and/or complete universal service reform, local residential service, except in low cost urban or similarly densely populated areas or provided by means of alternative technology or resale, will be uneconomical for competitors to provide. Consequently, there is a dearth of local residential competition, but there is significant local business telephone competition. As the Department of Justice observed in its recent Evaluation of Bell Atlantic=s New York interLATA application, loops in Manhattan are 2000 times more dense than in upstate New York. Such density will economically support both competitive business and residential service, but low density in rural areas, for instance, will not.

The 1996 Act has, as we have seen, accelerated the trend towards competition in the provision of local telephone service. Competitors, however, are immediately drawn to the business customers of the ILEC, because the CLEC realizes that the ILEC in most states is still required to price local telephone service to the business customer above cost in order to subsidize local telephone service. Quite obviously, this regulatory scheme is one that could exist in the monopoly telephone era, but not the competitive. Neither the states nor the FCC have eliminated implicit subsidies, which seemed to be one of the clarion calls of the 1996 Act, even if rate rebalancing was not.

2. **Section 271 Relief**.C A second critical impediment to local competition is the failure to date to authorize a single RBOC to provide interLATA telecommunications service in their regions. I doubt seriously if any of you who were on the Committee in 1995 and 1996 would have ever envisioned that statement being made at the end of 1999 C 3 years and 9 months after the 1996 Act=s

signing. One of the principal goals of the 1996 Act was to get BOCs into the long distance market in order to enhance competition in that telecommunications market segment as well. The watchword during the consideration of the 1996 Act was ***simultaneity***, meaning that BOCs should be authorized to provide long distance through Section 271 simultaneous with the opening up of the local market through Section 251. ***Simultaneity*** was abandoned within six months of the 1996 Act=s passage. Chairman Pressler, for instance, opined on the Senate floor during debate on S. 652 that the Competitive Checklist would be easy for BOCs to pass, because it was simply an amalgam of extant state regulatory requirements.

The 1996 Act=s requirements for RBOC entry were pretty straightforward. If a BOC had a facilities-based or predominantly facility-based competing provider of telephone exchange service to businesses and residences and if the RBOC met the 14-point checklist, the RBOC should be approved for long distance service if the FCC determined that entry was in the public interest. As Solomon Trujillo Chairman and CEO of US West testified before this Committee in April of this year, and reinforced in his letter of May 7, 1999 to Senators McCain and Hollings, the FCC has made this entry very much more complicated. In his letter, Mr. Trujillo pointed out that the 14-point statutory checklist has been, by US West=s fully documented count, increased to a ***690-point checklist***. Section 271(d)(4) of the 1996 Act prohibited the FCC from expanding the checklist. In 1999, to find out what requirements a BOC must meet for interLATA authority forget about the 1996 Act. The only place to find the state of the law at any one point is to look at all of the FCC orders and rules. As Mr. Trujillo pointed out, however, in his letter:

> Over the three years since passage of the Act, the FCC has conducted at least ten rule making proceedings creating Section 271 compliance obligations and has rejected each of the Section 271 applications filed by three different BOCs. ***A consistent pattern has emerged where each rulemaking and decision adds to or alters the compliance requirements, sometimes very significantly.*** (Emphasis Added)
>
> **The continually evolving nature of these requirements points up the difficulties** that BOCs face in their effort to obtain long distance relief within their regions. In performing the analysis necessary to identify these regulatory accretions to the statutory scheme enacted by the Congress, a number of regulatory approaches adopted by the FCC are so noteworthy that they require brief, separate discussion. (Emphasis Added)

> All told, the existing or proposed FCC requirements enumerated in the Study levy enormous operational, administrative and economic burdens on BOCs in their effort to gain Section 271 relief. ***The costs associated with meeting these requirements constitute a significant barrier to BOC entry into the interLATA market***. Insofar as these requirements are extended to BOC provision of advanced data services, as proposed by the FCC, they could also delay, if not foreclose, rapid, wide-scale entry by BOC=s into the broadband service market. (Emphasis Added)

Even the Department of Justice agrees that the compliance requirements for Section 271 have expanded. In its recent evaluation of Bell Atlantic=s New York application, the Department of Justice refers to the ***Aever receding finish line for meeting the requirements for entry into the long distance market.@***

Despite all of this, I am advised by the Bell operating companies that there are three very promising Section 271 applications in the pipeline: Bell Atlantic for New York; Bell South for Georgia; and SBC for Texas. These, I am advised, will even meet the 690-point checklist -- if the goalpost is not moved even further. Bell Atlantic=s application is currently before the FCC for its 90-day review, after having received the endorsement of the New York Public Service Commission following a lengthy and rigorous analysis by that state. The Department of Justice has even concluded that the FCC ***A... may be able to approve Bell Atlantic=s application at the culmination of these proceedings.@***

All three of these states (New York, Texas, Georgia) have facilities-based competition for both residential ***and*** business customers. An abbreviated snapshot of the competitive situation in these 3 states would be as described in the below chart:

STATE	**NEW YORK**	**TEXAS**	**GEORGIA**
CLEC Certifications	Over 500	294	138
Operational	CLECs	100	162

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CLEC Provided Access Lines	1.3 million	1.3 million	305,000

Today, long distance carriers have a very real incentive to keep the BOCs out of the in-Region interLATA business as they will surely lose some of their long distance market share to the BOCs. Consequently, they are not significantly entering the local telephone market for residential customers. This business customer oriented business plan will end in a hurry once the BOCs are given in-Region interLATA authority. A good example of this occurred in Connecticut where SNET, prior to being acquired by SBC, was allowed to offer a package of local and long distance services. Both AT&T and MCI lowered their intrastate long distance rates and offered a bundled package of local and long distance services to compete with SNET.

The failure to provide BOCs with interLATA relief is one of the most critical impediments to local competition. Once Section 271 relief is authorized, competitors will no longer purposely avoid serving residential subscribers. Today, if competitors provided wireline facilities-based services to both businesses and residences, this would unquestionably show that the local market is open, thus enabling BOCs to obtain Section 271 relief. Once BOCs are permitted to offer long distance, the long distance companies will find it necessary to enter the local market.

DEPLOYMENT OF ADVANCED SERVICES

The 1996 Act requires the FCC take steps in ensure rapid deployment of advanced telecommunications services as mandated in Section 706(b). There is no company that possesses market power in provision of advanced telecommunications service; hence, there is no reason for ILECs to be regulated differently than any other provider of advanced services. USTA agrees with AT&T CEO Michael Armstrong, who recently stated: ANo company will invest billions of dollars to become a facilities-base broadband services provider if competitors who have not invested a penny of capital nor taken an ounce of risk can come along and get a free ride on the investments and risks of others.@ All providers, CLECs, ILECs, and cable providers should receive the same regulatory treatment that is no regulation of advanced services regardless of who the provider is. Second, BOCs should be given immediate authority to provide interLATA data services in order to enhance the

Internet backbone and provide high speed Internet access throughout the country. Many, even relatively large cities and some states, have no Internet Point of Presence (POP).

There is no reason, for instance, why DSL which is an interstate telecommunications service should be regulated differently from Cable Modem Service, a cable service, but it is! DSL is pervasively regulated as a telecommunications service, but cable modem service is virtually unregulated as a cable service. Chairman Kennard just last week testified at the earlier cited House hearing that these two services, cable modem provided by cable operators and DSL services provided by ILECs are functionally equivalent. Look, however, at the regulatory differences between these two functionally equivalent services:

DSL v. CABLE MODEM SERVICE

ILECs	**CABLE OPERATORS**	
	DSL Service (an interstate telecommunications service)	**Cable Modem Service (a cable service)**
Common Carrier Duty	Every common carrier must furnish communications services upon request and establish physical connections ' 201(a)	***No Comparable Requirement***
Discrimination and Preferences	It shall be unlawful for any common carrier to make any unjust or	unreasonable charges, practices or classification

	' 202(a)	***No Comparable Requirement***C Local franchise authority only regulates basic cable television rates and equipment; no rate regulation of cable modem service
Tariffs	Every common carrier must file with the FCC schedules showing all charges for services provided ' 203(b)	***No Comparable Requirement***C Cable operator must file rates for basic tier and equipment with local franchise authority
Extension of Lines	No carrier shall construct a new line nor terminate an existing line without FCC approval ' 214(a)	***No Comparable Requirement***C Local franchise authority negotiates build-out requirements with cable operator
Annual Reports	The FCC is authorized to require carriers to file annual reports	***No Comparable Requirement***
Depreciation	The FCC may prescribe depreciation charges ' 220(b)	***No Comparable Requirement***
Accounts	The FCC may prescribe the forms for any and all accounts and establish a uniform system of accounts ' 220(a)	***No Comparable Requirement***
Subscriber List Information	A telecommunications carrier shall provide subscriber list information available on an unbundled and nondiscriminatory basis ' 222(e)	***No Comparable Requirement***
Interconnection	Incumbent Local Exchange Carriers (ILECs) have a duty to interconnect with the facility and equipment of any requesting telecommunications carriers ' 251(c)(1)	***No Comparable Requirement***
Resale	ILEC must offer its telecommunications services at wholesale rates 251(c)(4)	***No Comparable Requirement***C Leased access obligations C 10-

15% based on channel capacity		
Number Portability	Local exchange carriers (LECs) must provide number portability to the extent technically feasible ' 251(c)(2)	***No Comparable Requirement***
Dialing Parity	LEC must provide dialing parity to competing providers ' 251(b)(3)	***No Comparable Requirement***
Reciprocal Compensation	LECs have the duty to establish reciprocal compensation arrangements ' 251(b)(5)	***No Comparable Requirement***
Duty to Negotiate	ILECs have the duty to negotiate access to their networks with any requesting telecommunications carrier	***No Comparable Requirement***
Unbundled Access	ILECs have the duty to provide any requesting telecommunications carrier with non-discriminatory access to network elements on an unbundled basis ' 251(c)(3)	***No Comparable Requirement***
Collocation	ILECs have a duty to provide physical collocation of equipment necessary for interconnection or unbundled access ' 251(c)(6)	***No Comparable Requirement***
Universal Service	All telecommunications carriers shall provide schools, libraries, and health care providers access to services at discounted rates ' 254(h)	***No Comparable Requirement***
InterLATA	No Bell operating company may provide interLATA DSL services without prior FCC approval and competitive checklist compliance ' 271	***No Comparable Requirement***
Separate Subsidiaries	InterLATA telecommunications and information services must be provided through a separate affiliate ' 272(a)(2)	***No Comparable Requirement***
Electronic Publishing		

BOCs may provide electronic publishing only through a separate affiliate '274	***No Comparable Requirement***	
Alarm Monitoring	BOCs cannot provide alarm monitoring until 2001	***No Comparable Requirement***
Computer III/ONA	BOC/GTE required to provide access and unbundling for ESPs (ISPs)	***No Comparable Requirement***

The Internet is changing the world in ways never contemplated. Data and high speed access to the Internet are the important competitive matters of today and tomorrow and this is no David/Goliath story. ILECs have as their principal competitors in advanced services such companies as AT&T, which when its Media One merger is complete, will be not only one of the nation=s largest long distance telephone carrier, but also the #1 cable television company. In the area of cable-based, high-speed Internet access, AT&T would own 78% of @Home (330,000 customers) as well as nearly 40% of Road Runner (~75,000 subscribers) C bringing AT&T one step closer to offering a nationwide, all-in-one Internet, video and voice communications service. AT&T will have direct access to at least 60% of U.S. homes. Moreover, AT&T will also have significant chunks of:

- C Three of the top four cable firms
- C The two largest high-speed Internet companies, and
- C A share of virtually every major cable TV network

CONCLUSION

To summarize, there is certainly competition for business subscribers. Residential competition has been frustrated by the failure of most states to rebalance local phone rates, and the failure of the FCC and most states to reform universal service to eliminate implicit universal service subsidies. Third, we need regulatory parity in the provision of advanced services C cable modem service and DSL service are functionally equivalent and neither should be regulated.